

Decision _____

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Application of San Diego Gas & Electric Company (U 902-M) for Authority to Implement a Distribution Performance-Based Ratemaking Mechanism.

Application 98-01-014
(Motion Filed July 16, 2001)

In the Matter of the Application of Southern California Gas Company to Adopt Performance Based Regulation ("PBR") for Base Rates to be Effective January 1, 1997.

Application 95-06-002
(Motion Filed July 16, 2001)

Joint Application of Pacific Enterprises, Enova Corporation, Mineral Energy Company, B Mineral Energy Sub and G Mineral Energy Sub for Approval of a Plan of Merger of Pacific Enterprises and Enova Corporation with and into B Energy Sub ("Newco Pacific Sub") and G Energy Sub ("Newco Enova Sub"), the Wholly-Owned Subsidiaries of a Newly Created Holding Company, Mineral Energy Company.

Application 96-10-038
(Motion Filed July 16, 2001)

O P I N I O N

San Diego Gas & Electric Company (SDG&E) and Southern California Gas Company (SoCalGas) move for a one-year deferral of their cost of service/performance-based ratemaking applications. SDG&E and SoCalGas state that on June 18, 2001, the State of California (through the California Department of Water Resources or DWR), SDG&E and, as to certain provisions, Sempra Energy (the holding company of both SDG&E and SoCalGas) signed a Memorandum of Understanding (the DWR/SDG&E MOU) the primary purpose

of which is to ensure the continued provision by SDG&E of affordable and reliable electricity to its customers. The DWR/SDG&E MOU, as one of its objectives, proposes a plan for eliminating certain deferred electric commodity costs incurred by residential and small commercial customers of SDG&E (also known as AB 265 customers). The plan requires a series of actions by the Commission, referred to as “CPUC Implementing Decisions.”

One of the CPUC Implementing Decisions concerns the upcoming cost of service (COS)/performance-based ratemaking (PBR) applications to be filed at the end of 2001 by SDG&E and SoCalGas. These applications would normally be litigated in 2002 based on a 2003 test year, thus resulting in new rates as of January 1, 2003. SDG&E and SoCalGas assert that apart from the DWR/SDG&E MOU, a one year deferral of the SDG&E and SoCalGas COS/PBR applications is in the public interest due to the current emphasis on resolving the substantial issues pertaining to the electric crisis in the state, and the strain the proceedings dealing with that crisis (along with other major rate applications to be filed over the next year) have on utility, Commission staff, and intervenor financial and personnel resources. In addition, the deferral will allow the SDG&E COS/PBR test year of 2004 to be aligned with the end of SONGS’ rate treatment on December 31, 2003.

SDG&E and SoCalGas request that the Commission grant a one-year deferral of their next COS/PBR applications, to set rates for a 2004 test year rather than the 2003 test year currently adopted, and to extend each utility’s current PBR mechanism for one year. They note that a similar motion by Southern California Edison (SCE) was granted in Decision 01-06-039. SCE’s PBR mechanism was extended by Decision 01-06-038.

SDG&E and SoCalGas maintain that in ruling on this motion, we must determine how to account for continued merger related savings from the merger of Enova and Pacific Enterprises (D. 98-03-073)¹. In that decision we chose a five-year period to determine the allocable savings; savings were allocated on a 50/50 basis between ratepayers and shareholders; costs to achieve were to be amortized over five years; ratepayers were allocated \$174.9 million in total net savings, allocated among customer classes (SDG&E and SoCalGas) and also between gas and electric customers (SDG&E only); and, customers received bill credits of \$174.9 million over the five years.

As explained in D.98-03-073, the adopted treatment of merger savings was to last through December 31, 2002. Thereafter, the COS applications would provide new rates as of January 1, 2003. However, SDG&E and SoCalGas believe that because of the required deferral of the cost of service filings, it is necessary to adopt a methodology to deal with merger savings in the deferral year (i.e. 2003). They propose that the merger credit be calculated as set forth in Table 1, below, and then shared equally between customers and shareholders:

¹ Enova was the parent company of SDG&E; Pacific Enterprises was the parent company of SoCalGas. The parent companies were merged in D.98-03-073; the utilities were not merged but did modify their operations which resulted in merger related savings.

TABLE 1

| | <u>2002</u> | <u>2003</u> |
|---------------------------|----------------|-----------------|
| SDG&E | | |
| Merger Savings (customer) | 20.7 | 21.3 <i>(l)</i> |
| Less Costs to Achieve | <u>(4.8)</u> | <u>-</u> |
| Net Merger Credit | 15.9 | 21.3 |
| SoCalGas: | | |
| Merger Savings (customer) | 42.9 | 44.2 <i>(l)</i> |
| Less Costs to Achieve | <u>(10.00)</u> | <u>-</u> |
| Net Merger Credit | 32.9 | 44.2 |
| Total: | | |
| Merger Savings (customer) | 63.6 | 65.5 |
| Less Costs to Achieve | <u>(14.8)</u> | <u>-</u> |
| Net Merger Credit | 48.8 | 65.5 |

(l) Reflects 2002 amount escalated by 3% estimated inflation factor.

Using this methodology, the merger savings from 2002 are used as a base, but are then adjusted for inflation and to back out the “costs to achieve” which will have been fully amortized. SDG&E/SoCalGas submit that this is a reasonable manner in which to calculate the merger credit for the year 2003, which would then be shared equally (50/50) between customers and shareholders.

SDG&E and SoCalGas show an adopted 2002 merger savings credit to ratepayers (not including the effect of “costs to achieve”, which will be fully amortized by the end of 2002) of \$63.6 million. SDG&E and SoCalGas arrive at their proposed credit for 2003 of \$65.5 million by escalating the \$63.6 million by 3% for one year of inflation. However, the 2002 credit of \$63.6 million includes \$6.8 million in categories of savings that were allocated 100% to ratepayers by the merger decision, even in years 1 through 5; see D.98-03-073 at p. 19 showing Year 1-5 cumulative “Savings Subject to Balancing Accounts (100% Ratepayer)” as \$24.2 million for DSM, CARE and LEV, and \$6.8 million for RD&D. This total of

\$31 million was spread over each of the five years 1998-2002 by Advice Letter 2725, which implemented the merger decision credits. The amount shown for 2002 in Advice Letter 2735 in this category is \$6.8 million.

The remaining \$56.8 million of the 2002 credit was arrived at through a 50/50 allocation between ratepayers and shareholders. Thus, when allocating 100% to ratepayers in 2003, only the portion of the credit previously allocated 50/50 should be doubled (and then adjusted for inflation).²

The correct calculation for 2003 is:

1. 2002 credit related to savings previously split 50/50: \$56.8 million.
2. 100% ratepayer allocation previously split 50/50: $\$56.8 \times 2 = \113.6 million.
3. 2002 credit related to savings previously allocated 100% to ratepayers: 6.8 million.
4. 100% credit to ratepayers of all savings, in 2002 \$: $\$113.6 + \$6.8 = \$120.4$ million.
5. Escalate to 2003 \$ at 3% inflation: $\$120.4 \times 1.03 = \124 million³.

The Office of Ratepayer Advocates (ORA) favors granting SDG&E's and SoCalGas' request to defer their proposed COS/PBR applications for one year. However, ORA opposes their request to continue sharing the savings resulting

² Merger savings relating to costs not allowed in rates, such as savings by unregulated affiliates and savings in Long-term Incentive Plan compensation to utility employees, are not included in any of the figures referenced here.

³ Using the factors to allocate between SDG&E and SoCalGas ratepayers (SDG&E, 32.6%; SoCalGas, 67.4%) already adopted by the Commission, the split is \$40.4 million to SDG&E ratepayers and \$83.6 million to SoCalGas ratepayers.

from the merger for an additional year. ORA argues that not only is the latter aspect of the request contrary to established Commission precedent and inappropriate as a matter of public policy, but also it is procedurally improper in that SDG&E and SoCalGas are using a motion – instead of a Petition for Modification – to attempt to modify a Commission decision. The Commission has made it clear that any allocation of merger savings to shareholders should be terminated at the conclusion of the year 2002. (See D.98-03-073, *mimeo.* pp. 12-16.) According to the holding of D.98-03-073, merger savings for the years 2003 and beyond must accrue to the benefit of ratepayers either through a cost of service study or a properly constructed bill credit. Under SDG&E's and SoCalGas' proposal, Sempra shareholders would receive an undeserved \$62 million windfall simply because the Commission agreed to defer their COS/PBR applications. The Commission clearly expressed its intent in D.98-03-073 to terminate the shareholders' allocation of merger savings at the conclusion of the five-year sharing period, which ends December 31, 2002.

ORA asserts that if the COS/PBRs for SDG&E and SoCalGas were to remain on the currently ordered schedules for test year 2003, the end of shareholder sharing would be accomplished by incorporating the merger savings results into a new cost of service analysis, which would use the most recent recorded data, including the effect of reduced spending because of the merger. The actual achieved savings are then reflected as reductions to the costs that are adopted for determining future rates. In this way, merger savings associated with the regulated utility business would accrue 100% to the benefit of the ratepayers.

If the COS/PBRs for SDG&E and SoCalGas are to be deferred for one year as requested, the issue of how to handle merger savings in year six must be

decided. ORA recommends that the Commission develop an estimate of merger savings for 2003 for SDG&E and SoCalGas. Once a merger savings figure for 2003 has been determined a bill credit should be established, similar to the merger bill credit currently in effect for both SDG&E and SoCalGas. This bill credit would be calculated to return 100% of the estimated savings to ratepayers. ORA requests that the Commission deny those portions of the motion related to continuing shareholder sharing of merger savings beyond year five.

We agree with ORA. We will grant the motion (1) to defer the cost of COS/PBR applications for one year, and (2) to extend each utility's current PBR mechanism for one year. We base our decision on the need to make the most effective use of the Commission's and parties' resources. In D.01-06-039 we ordered Southern California Edison Company (SCE) to defer its general rate case (GRC) proceeding until Test Year 2003. This approach is consistent with the upcoming GRCs and related energy proceedings. In regard to the merger savings 50/50 sharing in the year 2003, we deny the motion. ORA's argument that post-2002 all merger savings should accrue to the ratepayers is persuasive. That is the result which would have occurred had the utilities filed timely COS/PBRs; it should not be halved because of the utilities' requested deferral. We will adopt the utilities' estimate of 2003 merger savings of \$124 million and order it refunded to ratepayers in the same manner as current merger savings are refunded, except for the refund to SDG&E's electric ratepayers.

It is in the public interest to refund the merger credit allocable to SDG&E's electric ratepayers of 62%,⁴ as a credit to the Transition Cost Balancing Account

⁴ The total merger credit allocable to SDG&E is further allocated 62% to SDG&E's electric ratepayers and 38% to SDG&E's gas ratepayers.

(TCBA). The NPV in 2001 of the sum the three years' allocation to SDG&E's electric ratepayers is about \$29 million. By adopting a 100% allocation to ratepayers in 2003, the 2003 merger savings allocation to SDG&E's electric ratepayers is approximately \$25 million instead of \$13.2 million, and the NPV in 2001 of crediting the three years' electric allocation to the TCBA is just over \$39 million instead of \$29 million.

The undercollected amount to be transferred to the TCBA is in excess of the net present value of the 2001-2003 merger savings allocable to SDG&E's electric ratepayers. Thus accelerating the merger savings refund through a credit to the TCBA would allow the TCBA to be eliminated sooner, providing much needed rate relief to SDG&E's electric ratepayers sooner. Merger savings allocable to SDG&E's gas ratepayers and to SoCalGas' ratepayers for 2001, 2002 and 2003 should still be refunded through a once-a-year bill credit.

We do not base our decision on SDG&E's MOU with DWR, nor do we take any position on the MOU in this decision.

Comments on Draft Decision

The draft decision of the ALJ in this matter was mailed to the parties in accordance with Pub. Util. Code § 311(g)(1) and Rule 77.7 of the Rules of Practice and Procedure. Comments were filed by ORA, TURN, and SoCalGas-SDG&E. Reply comments were filed by ORA, SoCalGas-SDG&E and the Natural Resources Defense Council (NRDC). SoCalGas-SDG&E's comments restated its prior arguments, corrected an error in the computation of the refund, and proposed a more efficient method of refunding merger savings to SDG&E's electric ratepayers. NRDC supports the one-year deferral, but proposes that the utilities modify their current rate indexing mechanism, by changing to a revenue-per-customer mechanism.

We have modified this decision to adopt the SoCalGas-SDG&E computational correction. Rather than a refund of \$131 million as originally proposed in the draft decision, we have corrected it to \$124 million. ORA agrees with this correction. We have also adopted the SoCalGas-SDG&E method of refunding to SDG&E's electric ratepayers. ORA agrees with this method. NRDC's proposal is more suited to a general rate case than a motion for deferral; it is rejected.

Findings of Fact

1. A one year deferral of the SDG&E and SoCalGas COS/PBR applications is consistent with the Commission's priorities with respect to upcoming GRCs and related proceedings for all energy utilities.
2. If the COS/PBR applications had been filed in a timely manner the merger savings of D.98-03-073, currently divided 50/50 between the utilities and ratepayers, would all accrue to the ratepayers.
3. A delay in the utilities' COS/PBR applications should not adversely affect ratepayers.
4. The utilities' estimate of merger savings in 2003 of \$124 million is reasonable; it should be refunded to ratepayers in the same manner as current merger savings are refunded, except for refunds due SDG&E's electric ratepayers, which should be refunded by a credit to SDG&E's TCBA, as set forth in this decision.

Conclusion of Law

The motion of SDG&E and SoCalGas is granted to the extent set forth in the order.

O R D E R

IT IS ORDERED that:

1. San Diego Gas & Electric Company and Southern California Gas Company shall defer their cost of service and performance-based ratemaking applications for one year and base them on a 2004 test year.

2. The merger savings in Year 2003 is deemed to be \$124 million, to be refunded 100% to ratepayers in the same manner as current merger savings are refunded, except for refunds due SDG&E's electric ratepayers, which should be refunded by a credit to SDG&E's TCBA, as set forth in this decision.

3. These proceedings are closed.

This order is effective today.

Dated _____, at San Francisco, California.